

POST 2006 INITIATIVE

**FINAL REPORT TO THE
ILLINOIS COMMERCE COMMISSION
PRESENTED BY THE
PROCUREMENT WORKING GROUP**

CONVENER: DAVID F. VITE

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LETTER OF TRANSMITTAL

PROCUREMENT WORKING GROUP

Dear Commissioners:

The Procurement Working Group (PWG) began its monumental task of vetting various scenarios for Power Procurement in the Post 2006 era on May 4, 2004. This process was accomplished only through the cooperative and dedicated efforts of all of the “stakeholders” involved in our arduous process. The Working Group met 14 times for a total of more than 52 hours in the discussions of the various strategies for procuring power following the current transition.

At the first meeting participants were informed by Commissioner Erin O’Connell-Diaz of the applicability of the Illinois Commerce Commission’s traditional policy barring the subsequent use of non consensus “positions taken, and documents and papers provided by the stakeholders in the Post 2006 initiative process in any subsequent litigation, including administrative proceedings before the Illinois Commerce Commission, the Federal Regulatory Commission and other federal, state or local government authorities.” In addition, the group was reminded of the importance of the strict compliance with all anti-trust laws and was referred to the Anti-trust Guidelines for the Post 2006 Initiative prepared under the supervision of the ICC General Counsel.

It was agreed by the PWG that our process would include “factual” presentations of each scenario developed in the initial Post 2006 Initiative discussions followed by a plenary discussion to develop a thorough understanding of each scenario. Following discussion participants were encouraged to file comments regarding the “Pros and Cons” of each specific scenario. All comments were forwarded to participants prior to a final discussion on consensus items describing the “pros and cons” of the scenario.

The group was then provided a draft of each “pro and con” consensus list at a subsequent meeting. These “consensus” items were either agreed or modified and a final list of consensus “pros and cons” was adopted for each scenario. This process was completed for 12 of the 13 scenarios which were presented. By consensus, it was agreed that, Scenario 12 which envisioned adoption of a renewable portfolio standard or target would not conclude with a “pros and cons” consensus position. In lieu of a consensus position each of the other 12 scenarios includes a reference as to whether or not a renewable portfolio standard or target would be allowed or accommodated under each scenario.

Subsequent to the groups' completion of the "pros and cons" consensus documents for all assigned scenarios it considered, modified and adopted a document called "Procurement Consensus Attributes". The group agreed that any procurement process adopted through legislative fiat or by Commission rule should include, to the extent possible, the attributes enumerated in that document. This effort was designed to provide guidance to either the Legislature or the Commission as they approach their respective responsibilities for the "post" transition period. This document was the group's effort to provide as much guidance as possible without giving specific preference to any procurement process. The group agreed, given the wide range of opinions among the "stakeholders", that it would be next to impossible to recommend either a specific scenario or to rank scenarios in order of preference.

This report of the activities of the Procurement Working Group provides a "good faith consensus" road map for policy makers to consider when making the final decisions on energy procurement policy in the Post 2006 era. Given the broad diversity of opinions of the "stakeholders" involved in the discussions this report is the most thorough response possible to the challenges presented by the Commission to the Procurement Working Group. The Procurement Working Group did everything possible to create consensus, to blend the needs of the wide range of "stakeholders" and to insure that consumers of all sectors will benefit in the Post 2006 era. Every participant worked to achieve a "good faith" compromise on issues which have significant impact on each and every type of "stakeholder". The group attempted to precisely define, discuss and agree in as many areas as possible. This report provides the most definitive presentation of Procurement strategies and represents the most comprehensive compilation of consensus positions.

The reports that follow begin with the "Consensus for Procurement Attributes" followed by a short description of each Scenario and its' consensus "pro and con" document. The Appendix provides a copy of the "presentations" made for each Scenario. It also includes a participant list, meeting agendas and minutes.

On a personal note, please accept my thanks for allowing me to convene the PWG. It was an honor to work with such a distinguished and learned group of participants. While our work was sometime tedious, all in the group worked arduously to complete our task in a cooperative spirit. Everyone toiled to understand the issues and to be mindful of the needs and positions of this diverse universe of "stakeholders". Without that effort and a positive view of the future, this report would not have provided this volume of "consensus" positions.

David F. Vite
Convener/Recorder
September 23, 2004

Procurement Consensus Attributes

The Procurement Working Group agrees that any approved procurement process, should include the following attributes:

Feature

1. It should be highly transparent.
2. It should allow for a competitive procurement approach.
3. It should provide for the opportunity for full cost recovery to the utilities if they follow the ICC approved procurement approach.
4. It should result in market-based rates for customers.
5. It should include a mechanism for translating the result of the process into retail rates.
6. It should facilitate and encourage supplier participation of all types in the wholesale market.
7. It should facilitate stable rates and mitigate rate volatility for applicable customers for relevant time periods.
8. It should allow for and accommodate RPS, DSM, low income assistance programs, etc.
9. It should require an initial regulatory review to approve and an ongoing regulatory review to oversee and improve the procurement process.
10. It should be capable of implementation prior to January 1, 2007.
11. It should provide specific guidance on crucial issues such as procurement methodology, rate design and allocation of risks and provide flexibility to respond to market conditions.
12. It should provide an agreed upon procurement methodology, which if followed, minimizes the need for after the fact prudence review.
13. It should for reasonable features or contractual safeguards to manage counterparty credit risk.

14. It should reflect lessons learned from States that have restructured and the current state of competition in the retail and wholesale markets in Illinois.
15. Stakeholders should have the opportunity to review and comment on the procurement process and proposed actions.
16. It should clearly assign accountability and risks.
17. It should provide for prompt regulatory review and approval.
18. The stated public policy goals of insuring resource adequacy should be considered in the procurement process or elsewhere.

Scenario 1: Vertical Auction

Definition: Wholesale market acquisition through “full requirements” auctions. This scenario envisions a load serving entity (“LSE”) “vertically” dividing the load obligation being auctioned into tranches, each of which has the same load shape as the total load being auctioned. Prospective suppliers, which may include affiliates, offer full requirements products to serve one or more tranches, with the winning suppliers being selected via an auction. This process could be used for total load or for the load of one or more classes.

- The price for the full-requirements product is set in a uniform-price, descending-clock reverse auction process
 - Uniform price means a single clearing price (i.e., the price level at which supply equals demand in the auction).
 - Descending-clock means the auction starts at a high price and “ticks” down as long as supply exceeds demand
 - Reverse auction means an auction to purchase, rather than sell, energy and capacity and associated products
- The full-requirements product represents a slice of system load
- Each auction participant competes to supply a fixed percentage share (or slice) of system load at the clearing price
- The auction winners procure supply in the different energy and capacity markets, and risk-manage their purchases
- The auction can include a cap on the amount of load any one participant can win
- Direct auction participants are prohibited from selling the auction product to other direct participants, but may sell standard products (e.g., 5 x 16 energy) and certain non-standard products to other direct participants
- The auction winners sell the full-requirements product to the distribution company at a fixed price (the clearing price); the distribution company transforms the clearing price into retail rate designs for eventual sale to the customers
- All auction processes are approved up front
- The product definition and other terms and conditions are documented in a master agreement that is approved up front
- The terms of the auction are staggered so that clearing prices are averaged from year to year, thus diminishing year on year volatility
- The fixed-price auction sets rates for residential and small commercial and industrial customers
- A second auction sets capacity prices for larger commercial and industrial customers, who also pay the hourly spot energy price for their energy requirements

SCENARIOS 1 AND 2

STANDARD OFFER APPROACH

PROS

1. Highly transparent, potentially competitive procurement approach. **Consensus Agreed**
2. The allocation of risks and responsibilities largely shifts to suppliers. **Consensus Agreed**
3. These models provide greater certainty of cost recovery to incumbent utilities compared to traditional rate-making principles involving after-the-fact prudence reviews. **Consensus Agreed**
4. Results in market-based rates for customers. **Consensus Agreed**
5. Each approach appears to allow for a mechanism for translation of the winning bid price into applicable rate structure. **Consensus Agreed**
6. Established operational and regulatory track record in other retail access states. **Consensus Agreed**
7. Only a limited amount of oversight is needed. **Consensus Agreed**
8. A properly designed auction, with small enough “tranches” and a upper limit on the number of “tranches” that any one bidder can serve, would address some of the market power and affiliate concerns. **Consensus Agreed**
9. Both approaches would tend to facilitate and encourage supplier participation in the wholesale market. **Consensus Agreed**
10. Both approaches appear to be capable of producing predictable, market based rates for end use customers during relevant time periods (monthly, quarterly, annually or multi-year periods). **Consensus Agreed**
11. Avoids complicated and contentious generation rate negotiations. **Consensus Agreed**

12. Allows for responsive incorporation of price responsive RPS green power requirements.

Consensus Agreed

13. Rolling multi-year “energy-plus capacity” procurement process mitigates rate volatility for residential and small C&I customers. **Consensus Agreed**

14. Provides full regulatory review each year with annual opportunities to improve subsequent solicitations and auctions. **Consensus Agreed**

CONS

1. Less akin to IRP process and "Energy Plans". **Consensus Agreed**

2. Full requirements rather than traditional energy products (block energy forwards, options); may require teaming for single asset suppliers. But : wholesale market offers these functions. **Consensus Agreed**

3. Rate design and allocation process should be pre-specified. But: rate structure can still be independent from bidding format; changes in rate designs impose risks on all full-requirements suppliers. (either utility or wholesale suppliers) **Consensus Agreed**

4. May limit the number of players. **Consensus Agreed**

5. Need to clearly address assignment of financial risks in cases of supplier default. **Consensus Agreed**

6. The issue of market concentration needs to be addressed. **Consensus Agreed**

7. Both approaches could result in unreasonable prices to end-use customers due to a lack of competition in the wholesale market. **Consensus Agreed**

8. An "off the shelf" auction from another state may not work here. **Consensus Agreed**

9. A "from scratch" auction could take considerable time and expense to implement. **Consensus Agreed**

10. A failed auction may leave customer classes exposed to spot prices without any alternatives available to them. **Consensus Agreed**

11. In the current market, auction or RFP processes for only 1-3 year energy and capacity products could be insufficient to attract new generation investment. **Consensus Agreed**

Scenario 2: Full Requirements RFP Process Summary

Standard Offer Description:

The “Standard Offer Approach” would consist of an RFP for slices of load for regulated full requirement service (each slice is the same product). The number of “load shares” or tranches can be set to supply customer class load or the system load.

Each supplier is responsible for energy, capacity, reserves, AS, losses, and deliverability to system, while the utility remains as the LSE and passes through FTRs and NITS costs.

The suppliers must acquire and manage the portfolio necessary to meet their obligation, which includes load-following responsibility.

RFP Process Description:

ICC would pre-approve design of the RFP approach, with resulting contracts deemed prudent.

ICC maintains oversight:

- Approval of state-wide framework (based on broad settlement)
- Pre-approval of utilities’ specific procurement design (based on broad settlement)
- Independent monitoring of entire procurement and bid evaluation process
- Approval of bids selected from each RFP round within two business days

The cost of an ICC approved RFP outcome becomes generation component of retail rates for regulated supply service (i.e., costs are passed through).

Overlapping multi-year contracts are used to manage market volatility.

All procurement costs are recovered in rates subject to true up.

Bidder prequalification requirements:

- PJM or MISO member in good standing; FERC market-based rate authority
- Credit requirements and financial information
- Bid Assurance Collateral (specified amount per tranche)

Awarded bids require posting of additional collateral by suppliers with poor credit rating.

In the event of supplier default:

- Other suppliers can “step up” to fill gap
- Utility purchases remainder in PJM or MISO until longer-term solution can be proposed

The customer rate components are based on the weighted average of all bid components.

The annual RFP cycle is on the same timeline for the state’s utilities.

With the transparency of process, affiliates are allowed to participate without restriction

SCENARIOS 1 AND 2

STANDARD OFFER APPROACH

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12. Allows for responsive incorporation of price responsive RPS green power requirements. **Consensus Agreed**

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3. Rate design and allocation process should be pre-specified. But: rate structure can still be independent from bidding format; changes in rate designs impose risks on all full-requirements suppliers. (either utility or wholesale suppliers) **Consensus Agreed**

4. May limit the number of players. **Consensus Agreed**

5. Need to clearly address assignment of financial risks in cases of supplier default. **Consensus Agreed**

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Illinois Post-2006 PROCUREMENT PROCESS

SCENARIO 3: HORIZONTAL PRODUCTS

Scenario 3 involves the division of a LSEs load into horizontal segments according to resource type (i.e. baseload, intermediate, peaking) or product category (i.e. 7x24, 5x16, 7x8). Independent procurement process or RFPs would be conducted within each segment or category. Ideally, each horizontal segment would be satisfied by a different supplier or set of suppliers via a contract with terms geared specifically to the characteristics of that particular segment. A variety of procurement processes, terms and conditions could be employed for each segment. Regulatory approval would be necessary for each wholesale product and term.

The approach found within this scenario is similar to the approach used to create the generating portfolios of existing investor-owned utilities. In essence, regulators and utilities used a rate-base process with implicit long-term contracts. Once an asset was approved in the utility's rate-base, there was a period of capital cost recovery that could last up to 40 years. However, this procedure of adding resources and cost recovery was justified by an underlying obligation for utilities to serve its load as it continued to grow.

A level of regulatory discretion is maintained with the forecasting, timing and management of the utility spending necessary for such projects. Assets are approved on a unit-by-unit basis rather than in full-requirements increments.

Each horizontal segment would have its own set of terms and conditions that will take into consideration industry/market practices, physical limitations of the generating source and other factors related to that segment. For example, the procurement process for the baseload segment could be long-term given the capital requirements of a new or retrofit plant. Another instance is the procurement for the peaking generation segment, where such processes could allow for index pricing given the underlying fuel volatility associated with natural gas and oil.

Consideration could be given to allowing a third party to conduct the bid process for the utilities to maintain transparency within this process.

SCENARIO 3

PROS AND CONS

PROS

1. Allows more flexibility in mix of products. **Consensus Agreed**
2. Provides for laddering of product types and terms which can dilute exposure to volatility or market power. **Consensus Agreed**

3. Facilitates generating companies with smaller or specialized asset portfolios being able to participate directly as suppliers to the utilities because the generating companies do not need diversified capacity mixes more critical to serving vertical tranches in order to participate. **Consensus Agreed**
4. To the extent this scenario provides for a priori approval of the portfolio by the regulator uncertainty associated with after-the-fact prudence reviews is reduced. **Consensus Agreed**
5. Regulators maintain close oversight over procurement policy **Consensus Agreed**
6. Competitive procurement process helps to ensure that supply prices reflect the costs of the most efficient suppliers **Consensus Agreed**
7. May ensure fuel/technology diversity in the region in order to reduce short-term exposure to specific fuel costs **Consensus Agreed**
8. May offer rate stability for customers and revenue stability for suppliers, through long-term supply contracts **Consensus Agreed**
9. Allows for DSM programs and renewable portfolio standards **Consensus Agreed**
10. Horizontal procurement allows for contracts of varying lengths, particularly longer-term contracts. **Consensus Agreed**
11. Provides for a flexible plan, developed in a transparent public process making use of regulatory, utility, and other stakeholder expertise, to manage risk on behalf of customers and to accommodate changing supply, demand and market conditions over time. **Consensus Agreed**
12. Facilitates generating companies with smaller or specialized asset portfolios (such as peakers) being able to participate directly as suppliers to the utilities. **Consensus Agreed**

CONS

1. Significant regulatory complexity involved in the review of the utilities' management of its portfolio of products; may require new/enhanced regulatory staff skills in risk management. **Consensus Agreed**
2. Potential for stranded costs if some products are contracted forward. **Consensus Agreed**
3. Any delays in regulatory approvals required for a utility to adapt its supply portfolio to changing market conditions may result in inefficient portfolio management. **Consensus Agreed**

4. Non-standard supply bids (dispatch flexibility, unit contingent, terms, etc.) require complex evaluation criteria for each product type. **Consensus Agreed**
5. May involve significant counterparty credit risk, especially if procurement is through long-term supply contracts where fuel cost is not fixed. **Consensus Agreed**
6. Can lead to possible stranded cost issues on long-term contracts as a result of customer switching. **Consensus Agreed**
7. Current forward markets only exist out to 3-years, so any price a bidder must submit for products with durations of longer than 3 years may involve greater uncertainty. **Consensus Agreed**
8. Several procurement portfolio policy decisions must be made and revisited, requiring incremental ongoing administrative costs and time **Consensus Agreed**
 - Product quantities, terms, and types (baseload/intermediate/peaking, dispatch flexibility, unit contingent, full-requirements, fuel/technology, etc.)
 - Bid format and/or evaluation criteria for each product
 - Approvals required for utility to adapt its supply portfolio to changing market conditions
9. To the extent there is inefficient portfolio management, there is the potential for higher customer rates **Consensus Agreed**
 - Time required for approval of changes in the resource / investment plan may cause delays that make portfolio management inflexible to changing market conditions
 - No guarantee that the most efficient risk managers manage risk
10. Incremental transaction costs may be incurred due to implementation of several different auctions/RFPs **Consensus Agreed**
11. Unless appropriate financial safe guards are included, may involve significant counterparty credit risk, if procurement is through especially long-term supply contracts **Consensus Agreed**

FACTS

1. The industry structure is vastly different today and will be in 2007 than it has been for the last 40 years. Because Horizontal Products best matched the past 40

years does not mean it will be the best match for future market structures. Utilities were able to plan for future customer load, but certain customers can now periodically switch to alternative suppliers whenever long-term utility supply costs exceed market prices. **Consensus Agreed**

2. Important issues regarding goals, responsibilities, and risk allocation would need to be addressed prior to implementation. **Consensus Agreed**
3. Prices could become “out-of-market” over time as a result of long term contracts. **Consensus Agreed**
4. Risks and responsibilities would be shared between suppliers and the utility. **Consensus Agreed**
5. This Scenario does not mandate fuel/technology diversity standards (E.G. clean coal development, RPS, etc.). **Consensus Agreed**
6. To the extent this scenario incorporates mandated fuel/technology diversity standards, some suppliers would be excluded from competing for portions of load requirements, thereby possibly increasing procurement costs and therefore customer rates **Consensus Agreed**

Scenario 3a: Smart Portfolio Management Process Summary

Overlapping multi-year contracts of several lengths and a portion of the portfolio allocated to long term renewable sources (not subject to fossil fuel price risk) are used to manage market volatility and exposure to other power supply risks.

Standard Offer Description:

The “Standard Offer Approach” would consist of developing a managed portfolio of resources, including a ladder set of power contracts with a variety of short to medium length durations and expiration dates, carefully selected long term renewable resource contracts, and acquisition of cost effective energy efficiency resources. The ladder set power contracts would be acquired through annual auctions or RFPs for slices of load for regulated full requirement service as needed for the various products. The number of “load shares” or “tranches” can be set to supply that portion of the customer class load or the system load assigned to that part of the portfolio. Renewable resources would be acquired competitively via an RFP in increments driven by market conditions and availability. Efficiency resource acquisition would occur each year, driven by available market opportunities.

Each supplier in the power contract portion of the portfolio is responsible for residual energy, capacity, reserves, AS, losses, and deliverability to system, while the utility

remains as the LSE and passes through FTRs and NITS costs. Renewable contract supplier responsibility is for delivery of contracted installed capacity, although some technologies may support firm energy.

The bidders in the power contract portion of the portfolio must meet certain standards to pre-qualify for participation, as in scenarios 1 and 2. Those suppliers must acquire and manage the portfolio necessary to meet their obligations, which includes load-following responsibility.

Auction or RFP Process Description:

This scenario, like other competitive procurement models, is predicated on the existence of an effectively competitive wholesale market. The initial step in its implementation is an independent market assessment, which would also be conducted regularly thereafter. Upon a finding of effective competition in relevant markets, the ICC would pre-approve design of the auction or RFP approach and portfolio management standards. ICC maintains oversight:

- Approval of state-wide framework
- Pre-approval of utilities' specific procurement design and implementation plans
- Independent monitoring of entire procurement and bid evaluation process
- Approval or rejection of bids selected from each RFP or auction round within an appropriate time

Monitoring of procurement and bid evaluation process by consumer representatives would parallel that above oversight and provide recommendations to the ICC on bid approval. The cost of an ICC approved auction or RFP outcomes (including prior portfolio choices) becomes the generation component of retail rates for regulated supply service. However, the rates could be designed to maintain stability through rate collars or other methods to defer the initial impact of significant up or down movements. A backstop procurement plan would be ordered if the ICC rejected the results of the auction or RFP as non-competitive.

SCENARIO 3 a:
SMART PORTFOLIO MANAGEMENT

PROS

1. Allows more flexibility in mix of products. **(consensus agreed)**
2. Provides for laddering of product types and terms which can dilute exposure to volatility or market power. **(consensus agreed)**
3. Provides for a flexible plan, which may include long term and short term (including spot purchases) developed in a transparent public process making use of regulatory, utility, and other stakeholder expertise and including an assessment of wholesale supply contracts, market power, to manage risk on behalf of customers and suppliers accommodate changing supply, demand and market conditions over time. **(consensus agreed)**
4. May include auctions where appropriate as well as RFPs for competitive procurement. **(consensus agreed)**
5. Allows for non-price considerations to be included in portfolio planning, such as fuel and technology diversity, demand response programs, energy efficiency, and encouragement of new generator entry and investment and, as such, can enhance by security. **(consensus agreed)**
6. Assuming a competitive generation marketplace, results in market-based rates for customers.
(consensus agreed)
7. Would appear to be capable of producing stable rates for applicable customers and suppliers within relevant time periods (monthly, quarterly, annually or multi-year periods)
8. Allows for incorporation of RPS green power requirements. **(consensus agreed)**
9. Enhances wholesale competition and market liquidity by opening up the procurement process to third-party suppliers through the utilization of competitive bidding. **(consensus agreed)**
- 10 Facilitates generating companies with smaller or specialized asset portfolios being able to participate directly as suppliers to the utilities because the generating companies do not need diversified capacity mixes more critical to serving vertical tranches in order to participate.
(consensus agreed)

11. To the extent this scenario provides for a priori approval of the portfolio by the regulator uncertainty associated with after-the-fact prudence reviews is reduced. **(consensus agreed)**

CONS:

1. Significant regulatory complexity involved in the review of the utilities' management of its portfolio of products; may require new/enhanced regulatory staff skills in risk management. **(consensus agreed)**

2. Potential for stranded costs if some products are contracted forward. **(consensus agreed)**

3. Could result in unreasonable prices if there is a lack of competition in the wholesale market. **(consensus agreed)**

4. A failed auction without an alternative resolution may leave customer classes exposed to spot prices for some of their load for a period of time. **(consensus agreed)**

5. May create additional administrative costs and requirements on the ICC and all other "stakeholders" compared to other Scenarios. **(consensus agreed)**

6. Any delays in regulatory approvals required for a utility to adapt its supply portfolio to changing market conditions may result in inefficient portfolio management. **(consensus agreed)**

7. Non-standard supply bids (dispatch flexibility, unit contingent, terms, etc.) require complex evaluation criteria for each product type. **(consensus agreed)**

8. To the extent that this Scenario includes mandated motor fuel/technology diversity standards, some suppliers would be excluded from competing for portions of load requirements, even if they are lower cost suppliers. **(consensus agreed)**

9. May involve significant counterparty credit risk, especially if procurement is through long-term supply contracts where fuel cost is not fixed. **(consensus agreed)**

10. Can lead to possible stranded cost issues on long-term contracts as a result of customer switching. **(consensus agreed)**

11. Bidders must add additional price risk premium to contracts for tranches longer than 3-years. Current forward markets only exist out to 3-years, so any price a bidder must submit for products with durations of longer than 3 years may involve greater uncertainty. **(consensus agreed)**

FACTS

1. Important issues regarding goals, responsibilities, and risk allocation would need to be addressed prior to implementation. **(consensus agreed)**
2. Prices could become “out-of-market” over time as a result of long term contracts. **(consensus agreed)**
3. Suppliers of vertical tranches take on all generation-related responsibilities, including portfolio/risk management. **(consensus agreed)**
4. Risks and responsibilities would be shared between suppliers and the utility. **(consensus agreed)**
5. This Scenario does not mandate fuel/technology diversity standards (E.G. clean coal development, RPS, etc.). **(consensus agreed)**

Scenario 4: Affiliate Purchases

Definition: Affiliate purchases (including possible affiliate use of market acquisition). This scenario envisions the LSE contracting with an affiliate to satisfy all of the subject load obligation, including risk management. The affiliate, in turn, may contract with other suppliers to provide resources to meet its contractual obligation through market or other mechanisms.

Note: Scenario 4 concerned a full requirements power purchase contract between a utility and its generation affiliate with no market or other mechanism to set a competitive price as a proposed procurement methodology in the context of a post-2006 structure in Illinois where there is no rate freeze. It did not consider the utility **[application]** of affiliate contracts in other settings.

- The affiliate contract is typical of first-generation standard offer service
- The sale and purchase is done pursuant to a power purchase agreement (“PPA”) between the generation affiliate and the distribution company
- The product is full requirements, but typically does not include network service (i.e., the distribution company remains the network customer)
- The generation affiliate assumes all risk management functions associated with the full-requirements product
- The price for the product typically is market-based
- The distribution company transforms the PPA price into retail rate designs
- The product is identical to the full-requirements service that utilities have always provided to customers
- A new risk inherent in the product is retail choice migration risk

- Short-term and long-term load forecasting is still the responsibility of the distribution company

SCENARIO 4 AFFILIATE PURCHASES

PROS

1. Utilizes legacy portfolio and risk management expertise of utility affiliates. **(Consensus Agreed)**
2. Is compatible with various rate designs. **(Consensus Agreed)**
3. May provide stable rates for applicable customers. **(Consensus Agreed)**
4. Allows for incorporation of RPS green power requirements. **(Consensus Agreed)**

CONS

1. Not a transparent process. **(Consensus Agreed)**
2. Not a competitive procurement approach. **(Consensus Agreed)**
3. Resulting price for end use customer not tied to market. **(Consensus Agreed)**
4. Inconsistent with FERC affiliate transaction rules (i.e., Edgar test). **(Consensus Agreed)**
5. Does not foster wholesale competition. **(Consensus Agreed)**
6. Does not facilitate participation by non-affiliated generator or suppliers of all kinds. **(Consensus Agreed)**
7. Provides little or no opportunity for stakeholders to review and comment on utilities' procurement plans. **(Consensus Agreed)**
8. Limits the regulatory oversight by the ICC. **(Consensus Agreed)**
9. May engender federal/state regulatory conflict given the different policy objectives and standards used by ICC and FERC. **(Consensus Agreed)**
10. May be susceptible to affiliate abuse that may be difficult for regulators to detect. **(Consensus Agreed)**

11. Could facilitate the capture of excess profits by the regulated entity on behalf of its unregulated GENCO affiliate. **(Consensus Agreed)**
12. If market metrics are lacking, would hamper efforts to evaluate the performance and cost-effectiveness of the supply portfolio. **(Consensus Agreed)**
13. Provides a potentially inadequate incentive to procure power efficiently given the lack of competition and limited regulatory review. **(Consensus Agreed)**
14. Does not provide non-affiliated suppliers with the opportunity to participate directly as the supplier to the utility. **(Consensus Agreed)**
15. Inclusion of regulatory risk into supplier's pricing, if supplier's offer is fixed and the regulatory proceedings required for approval require extensive amounts of time. **(Consensus Agreed)**
16. May reduce market liquidity if supplier uses its own generation to serve a large portion of the supply obligation. **(Consensus Agreed)**

FACTS

1. Default risk is reduced if the supplier has a strong credit rating. **(Consensus Agreed)**
2. To the extent this scenario provides for a priori approval of the rates based on the supplier's price, it provides greater certainty of cost recovery to incumbent utilities compared to traditional rate-making principles involving after-the-fact prudence reviews. **(Consensus Agreed)**
3. Could involve regulatory proceedings in order to approve supplier's price, associated generation rates, and sole source procurement approach. **(Consensus Agreed)**

Scenario 5. Cost-index (e.g., MVI) based procurement regulation. This scenario envisions a regulatory process setting a price benchmark for commodity costs, or for commodity and risk management costs, based on an index or formula. Under current law, regardless of the scenario or procurement methodology, Section 16-111(i) of the Public Utilities Act indicates that the Illinois Commerce Commission can make use of a Market Value Index (MVI) as the measure by which to determine the "justness and reasonableness of the electric power and energy component of an electric utility's rates for tariffed services." The goal in designing Market Index based price for retail energy would be to ensure customers receive energy at a "market price" regardless of the procurement methodology employed. To achieve this goal, the market index would need to be made independent of, but relevant to, the prices in the electricity markets that service Illinois. Independence is important to insure that market participants cannot,

through their actions, directly influence the index. Relevance is important in that the index to ensure that it accurately reflects the cost of serving retail load in Illinois.

Under scenario 5, with an index mechanism in place, the regulated utility is free to design its own procurement strategy. While the MVI would not limit the price that could be paid to any one supplier, scenario 5 envisions an index which would define a benchmark for the load weighted bundle of prices that can be charged to tariffed customers based on a “market basket” of the costs of delivered energy. As such, the index would be used to set the average load weighted price of energy to tariffed customers.

This scenario could have the MVI act as a cap on the energy component of “bundled” service with no true-up/sharing mechanism. Alternatively, this scenario could include a sharing mechanism for procurement costs that are below and/or above the index. Where no sharing mechanism is used, the utility would receive all the benefits of finding energy for less than the MVI, but they would bear all of the risk of energy costs in excess of the MVI. Where a sharing mechanism is used, the difference between the MVI and the “actual costs” of an utility’s delivered power could be redistributed through a sharing mechanism (true-up). With sharing, the utility and customers would share the benefits of finding energy for less than the MVI, but they would also share the burden of procurement costs that exceed the MVI. Unlike a simple pass-through structure, the MVI scenario, with or without sharing, would provide an incentive for a utility to actively seek least cost power.

SCENARIO 5

PROS AND CONS

PROS

1. MVI-based rate-setting, if used as a price-capping mechanism, would help ensure that utility incentives include cost minimization. If the MVI includes a sharing of costs and savings the utility would have incentives to minimize costs. **Consensus Agreed**
2. This approach may reduce costs associated with regulatory oversight of the utility’s procurement practices **Consensus Agreed**
3. The regulatory burden and administrative costs of MVI are limited, once the MVI is set, because there is no need to review and approve LSE procurement actions before or after the fact. ICC just sets MVI-based price “cap” and ensures that ratepayers receive appropriate benefits when realized procurement costs are below those associated with the MVI cap. **Consensus Agreed**

4. Potential benefits to retail customers in terms of rate stability, if MVI is designed to include significant forward contracting or hedged supplies **Consensus Agreed**
5. On average customers gain some assurance of paying no more than the market price, assuming that MVI accurately reflects Illinois market conditions.
Consensus Agreed
6. As a “benchmark,” MVI provides a transparent and relatively simple means of assessing some aspects of wholesale market and procurement performance. In particular, it may inform whether changes in the cost of locally solicited supplies are reasonable in comparison to price changes elsewhere over the same time frame. **Consensus Agreed**
7. Allows for incorporation of RPS green power requirements. **Consensus Agreed**

CONS

1. Uncertain as to how the current MVI methodology may have to be modified to include risk management costs such as, customer switching rates and energy market volatility.
Consensus Agreed
2. MV cap provision of PUA if tied to MVI may discourage utilities from procuring contracts greater than one year duration **Consensus Agreed**
3. MV cap provision of PUA if tied to MVI may effectively limit procurement alternatives available to delivery only utilities to those that use the Index as the pricing method. **Consensus Agreed**
4. To the extent that the contracts which result from the procurement methodology do not define the MVI cap, this provision increases the risk profile to utilities, which could impair bond ratings. **Consensus Agreed**
5. In today’s’ market the MVI calculation accuracy for valuing forward market prices diminishes significantly beyond 1 year, so it could expose customers to shorter term market volatility **Consensus Agreed**
6. If the MVI were to be used as a benchmark for any purpose, then incremental administrative costs and time would need to be consumed in order to agree upon adjustments to the MVI to reflect the full market costs incurred by a provider of standard offer service **Consensus Agreed**

7. Development of the competitive retail market could be stymied if the administratively calculated MVI underestimates the true market value of power and energy **Consensus Agreed**
8. Without a cost sharing mechanism, the utility would be exposed to under-recovery of procurement costs whenever the administratively calculated MVI underestimates the true market-based procurement costs (especially if the MVI were used to set a rate cap, since there is no potential offsetting upside for the utility if the MVI overstates procurement costs) **Consensus Agreed**
9. It may prove difficult to design an MVI that adequately reflects reasonable differences between local and remote market prices (e.g., due to differences in the supply mix, reserve margin, congestion, load shapes, etc.). The MVI may not be a good proxy for efficient local procurement. **Consensus Agreed**
10. If the MVI is set only occasionally (i.e., not calculated dynamically, in comparison to each distinct procurement product), it will reflect only market conditions prevailing at that initial time. In a volatile market, that MVI will not reflect the fair value of services procured over different horizons or at different points in time, even if those procurements are all competitive and reasonable. **Consensus Agreed**
11. Absent customer switching restrictions if the MVI price is set as a fixed cap, it effectively forces the LSE to grant a free “call option” to customers. “Prodigal customers” may choose to leave their ARES and return to POLR if/when market conditions change. **Consensus Agreed**
12. Absent customer switching restrictions as a cap on power procurement costs, the call-option nature of MVI (or any other price cap) shifts all upside wholesale procurement price risk to LSEs. This is problematic and potentially very costly to the distribution company, given the observed volatility of wholesale electric markets. **Consensus Agreed**
13. The market for relatively long-term products (e.g., forward contracts of 1 year or longer) may be far less liquid than the market for short-term (e.g., daily, monthly, or quarterly) products. The LSE, however, may reasonably be asked to purchase a mix of short-term and long-term products at different points in time to lessen price risk. To provide an “apples to apples” comparison, the MVI would need to reflect the mix of products purchased by the LSE and the expectations pertaining at the time of purchase. With thin forward markets, which are common to electricity trading in many regions of the U.S., it may be inherently difficult to develop an MVI benchmark that is relevant to both short-term and long-term procurements. **Consensus Agreed**
14. Does not encourage the development of wholesale competition. **Consensus Agreed**

15. Absent significant changes in the underlying mechanics of the MVI process, directly tying the LDC's purchasing practices to the MVI may likely result in substantially all of the power and energy acquired by the major LDC's in the State, being priced simultaneously. Consumers could be at risk from the potential volatility in the wholesale market which may arise when such large volumes of power and energy are simultaneously bid in a relatively small geographical region, on an annual basis. **Consensus Agreed**

FACTS

1. Despite the ICC having adopted formulas for utilities to compute a market-value based on published index data, at the present time there is no single acceptable Index available to accurately measure the market value of power and energy in all areas of the state. **Consensus Agreed**
2. It is debatable whether Illinois Law mandates that the MVI be used as the basis for a rate cap under a competitive procurement approach **Consensus Agreed**
3. As presented this MVI Scenario could produce a formulaic market based cap on retail prices. **Consensus Agreed**
4. As presented this MVI Scenario does not provide a specific procurement methodology. **Consensus Agreed**

SCENARIO 6 – Market Assessment and Supply Procurement (MASP)

As presented, Scenario 6 represents a Market Assessment and Supply Procurement (MASP) approach consistent with traditional utility resource planning, but adapted to reflect competitive market structures. Scenario 6 would require utilities to make periodic assessments of wholesale and retail market conditions. These assessments, together with proposed supply procurement plans, would be filed by the utilities in docketed proceedings at the Illinois Commerce Commission ("Commission"). The Commission, after stakeholder input, would review and approve supply plans for each utility. The market assessments presented in the utility filings would include information to be used in determining whether the utilities' procurement strategies included the best means of procuring supply for standard-offer service customers.

A variety of procurement options can be considered and proposed under this scenario, including auctions, RFPs, and bilateral negotiations. However, this scenario envisions and presumes a competitive procurement process when market conditions are supportive of competition and provides for strict scrutiny of any proposed affiliate supply arrangements. Utilities would have flexibility to alter procurement strategies as market conditions (or projected market conditions)

change. If desired, this flexibility can be used to address issues such as price risk, renewable energy supplies, and long-term supply adequacy.

In this scenario, the extent of wholesale and retail market development may affect strategies toward acquiring electric power in support of utility standard-offer service obligations. For example, in a market dominated by customers using standard-offer service, desired utility procurement strategies may be different than those used when only a small percentage of customers remain on standard-offer service. In addition, procurement strategies may differ when wholesale electric markets are subject to robust competition, as opposed to conditions where these markets are prone to price spikes and transmission constraints that limit the delivery of power from neighboring areas.

The wholesale market assessments that would be required of the utilities under this scenario would consider local and regional price trends, supply adequacy, RTO structure within the state, seams issues, transmission system congestion, and market power. Among other aspects, the wholesale assessments would include an analysis of price trends, market concentration, financial strength, and market depth with respect to generation and spot and forward electricity trading.

The retail market assessments would look at changes in demand for competitive retail service by customer category and trends in retail prices. The retail assessments would consider the options available to retail customers by reviewing the service offers (by customer class, if applicable) and financial strength of the ARES active in the utility's service area.

In this scenario, the Commission's review of a utility's procurement plans and strategies occurs prior to the utility committing to specific resources. As such, the utility is able to secure Commission approval of its plans and an a priori prudence determination for rate purposes of those plans. A mechanism for the utility to recover the costs associated with approved supply procurements is included as part of the process.

SCENARIO 6

PROS

1. Is a flexible process providing transparent, comprehensive regulatory review of markets and utility procurement programs with opportunity for market participants to have timely review and input. **(Consensus Agreed)**
2. Supply planning provides a forum and mechanism to identify the need for near- and long-term resources to assure adequate supply and reliability. **(Consensus Agreed)**
3. Can be structured to provide flexibility for each utility to tailor a procurement program that addresses its specific requirements. **(Consensus Agreed)**
4. Can be structured to provide a presumption in favor of competitive procurement. **(Consensus Agreed)**

5. Can be structured to incorporate flexibility to adjust procurement strategies on a going forward basis to respond to changes in market conditions and RTO market structure. **(Consensus Agreed)**
6. Does not prejudge, mandate, or preclude any specific procurement program. **(Consensus Agreed)**
7. Provides review and approval of procurement strategies prior to a utility's commitment to specific resources. **(Consensus Agreed)**
8. Will help inform ICC for its participation in RTO and FERC proceedings through periodic wholesale market assessments. **(Consensus Agreed)**
9. Allows for DSM programs and renewable portfolio standards. **(Consensus Agreed)**
10. May facilitate direct participation by specialized or single asset owners. **(Consensus Agreed)**

CONS

1. Involves specific and detailed legislative changes necessary to support procurement for 2007 power supplies. **(Consensus Agreed)**
2. Involves a judgment-based review that does not lend itself to easily quantified metrics for decision-making. **(Consensus Agreed)**
3. It may not be possible to efficiently transition between procurement strategies as market conditions change. **(Consensus Agreed)**
4. To the extent that the utility would procure non-competitively, there is less transparency. **(Consensus Agreed)**
5. To the extent that utilities would manage a portfolio of assets, this duplicates risk management/hedging expertise which is currently in the affiliated GENCO's. **(Consensus Agreed)**
6. Could result in higher prices if the regulatory process requires the inclusion of above market resources in the portfolio. **(Consensus Agreed)**
7. Leaves several key and potentially contentious issues to be resolved in a later regulatory process, including procurement methodology, rate design, and allocation of risks. **(Consensus Agreed)**
8. To the extent procurement is through long-term supply contracts, this scenario may involve significant counterparty credit risk. **(Consensus Agreed)**

FACTS:

1. Concentrates expertise in the utilities to plan and arrange for supply requirements of bundled service customers with regulatory oversight of this activity. **(Consensus Agreed)**
2. Preserves the option of using other procurement methods when competition is not sufficiently robust. **(Consensus Agreed)**
3. Has not been proven as a default service procurement process in any state that has restructured and allows retail choice. **(Consensus Agreed)**
4. Though a wide variety of parties influence the final outcome, accountability and risk would rest on ratepayers and/or the utility. **(Consensus Agreed)**
5. Provides for full recovery of prudently incurred costs, provided utility procures in accordance with approved supply plan. **(Consensus Agreed)**
6. May not completely eliminate after-the-fact prudence reviews. **(Consensus Agreed)**
7. Historically, IRP review and procurement processes have been costly and time consuming for the ICC and the parties. **(Consensus Agreed)**

Scenario 7. Rate freeze / transition period extension (continuation of current regulation). This scenario envisions either an extension of the rate freeze but an end to the “transition period” or the extension of the Mandatory Transition Period, including rate freeze, beyond January 2, 2007. Under either scenario, utilities could file revised DST rates and otherwise restructure their rates in accordance with Article XVI, but utility rates would otherwise continue to be subject to the bundled rate “freeze” and the existing rules concerning service obligations and competitive declarations. The utility would be free to acquire power by any means, subject to the fact that cost recovery from bundled customers would be limited to current rates.

SCENARIO 7

PROS AND CONS

PROS

1. Depending on underlying market conditions, may yield favorable rates for consumers in the short term. **Consensus Agreed**
2. Could be made compatible with a competitive wholesale procurement process. **Consensus Agreed**
3. With modest legislative change could accommodate RPS green power requirements. **Consensus Agreed**

CONS

1. Cost to extend contracts beyond 2006 may be higher than what is reflected in current rates. **Consensus Agreed**
2. Possible lack of wholesale market development during extension due to uncertainty and prices that do not reflect market. **Consensus Agreed**
3. Inconsistent with FERC affiliate transaction rules. **Consensus Agreed**
4. Does not foster wholesale competition. **Consensus Agreed**
5. Utilities do not have opportunity to recover cost increases on the T&D component of rates. **Consensus Agreed**
6. Depending on underlying market condition, may lock in rates higher than what consumers might see absent a rate freeze. **Consensus Agreed**
7. May result in an extension of the practice of procurement through affiliate, full-requirements contracts, with the associated lack of transparency. **Consensus Agreed**
8. Does not make efforts to solve the issue of how to efficiently supply customers using standard-offer service. **Consensus Agreed**
9. Continues regulatory uncertainty, which may stifle investment in generation and other resources. **Consensus Agreed**
10. Depending on underlying market conditions, may lock in rates lower than what suppliers would see in the market, therefore eliminating any interest in serving the utility load by competitive suppliers. **Consensus Agreed**

Scenario 8. Transition period expires; regulation continues under existing post-2006 law. This scenario envisions that the Mandatory Transition Period expires without major legislative change. Under this scenario, the ICC will continue to regulate rates for non-competitive service customers under traditional rate regulation principles and the existing statutes applicable to the post-transition period. Utilities could procure energy through any lawful means, including affiliate purchases, subject to any applicable regulatory limitations or requirements for regulatory approval. An MVI would form the basis of prudence review of the bundle of energy purchases by the utilities, along with more traditional analysis of bundled and DST rate determination. Absent new rate cases, there would be an effective rate freeze.

SCENARIO 8

PROS AND CONS

PROS

1. To the extent that the MVI serves as a rate cap, the basis of a prudence review, or the basis for setting interim rates, this scenario has all of the "Pros" associated with Scenario 5. **Consensus Agreed**
 - MVI-based rate-setting, if used as a price-capping mechanism, would help ensure that utility incentives include cost minimization. If the MVI includes a sharing of costs and savings the utility would have incentives to minimize costs. **Consensus Agreed**
 - This approach may reduce costs associated with regulatory oversight of the utility's procurement practices **Consensus Agreed**
 - The regulatory burden and administrative costs of MVI are limited, once the MVI is set, because there is no need to review and approve LSE procurement actions before or after the fact. ICC just sets MVI-based price "cap" and ensures that ratepayers receive appropriate benefits when realized procurement costs are below those associated with the MVI cap. **Consensus Agreed**
 - Potential benefits to retail customers in terms of rate stability, if MVI is designed to include significant forward contracting or hedged supplies **Consensus Agreed**
 - On average customers gain some assurance of paying no more than the market price, assuming that MVI accurately reflects Illinois market conditions. **Consensus Agreed**

- As a “benchmark,” MVI provides a transparent and relatively simple means of assessing some aspects of wholesale market and procurement performance. In particular, it may inform whether changes in the cost of locally solicited supplies are reasonable in comparison to price changes elsewhere over the same time frame. **Consensus Agreed**
2. To the extent that a rate freeze remains in effect if there is no rate case, this scenario is virtually identical to the "Partial Extension" version of Scenario 7. Hence, it has both of the "Pros" associated with that scenario. **Consensus Agreed**
 - Depending on underlying market conditions, may yield favorable rates for consumers in the short term. **Consensus Agreed**
 - Could be made compatible with a competitive wholesale procurement process. **Consensus Agreed**
 3. Allows for incorporation of RPS green power requirements. **Consensus Agreed**

CONS

1. To the extent that MVI serves as a rate cap, the basis of a prudence review, or the basis for setting interim rates, this scenario has all the "Cons" associated with Scenario 5. **Consensus Agreed**
 - Uncertain as to how the current MVI methodology may have to be modified to include risk management costs such as, customer switching rates and energy market volatility. **Consensus Agreed**
 - MV cap provision of PUA if tied to MVI may discourage utilities from procuring contracts greater than one year duration **Consensus Agreed**
 - MV cap provision of PUA if tied to MVI may effectively limit procurement alternatives available to delivery only utilities to those that use the Index as the pricing method. **Consensus Agreed**
 - To the extent that the contracts which result from the procurement methodology do not define the MVI cap, this provision increases the risk profile to utilities, which could impair bond ratings. **Consensus Agreed**
 - In today's market the MVI calculation accuracy for valuing forward market prices diminishes significantly beyond 1 year, so it could expose customers to shorter term market volatility **Consensus Agreed**
 - If the MVI were to be used as a benchmark for any purpose, then incremental administrative costs and time would need to be consumed in

order to agree upon adjustments to the MVI to reflect the full market costs incurred by a provider of standard offer service **Consensus Agreed**

- Development of the competitive retail market could be stymied if the administratively calculated MVI underestimates the true market value of power and energy **Consensus Agreed**
- Without a cost sharing mechanism, the utility would be exposed to under-recovery of procurement costs whenever the administratively calculated MVI underestimates the true market-based procurement costs (especially if the MVI were used to set a rate cap, since there is no potential offsetting upside for the utility if the MVI overstates procurement costs) **Consensus Agreed**
- It may prove difficult to design an MVI that adequately reflects reasonable differences between local and remote market prices (e.g., due to differences in the supply mix, reserve margin, congestion, load shapes, etc.). The MVI may not be a good proxy for efficient local procurement. **Consensus Agreed**
- If the MVI is set only occasionally (i.e., not calculated dynamically, in comparison to each distinct procurement product), it will reflect only market conditions prevailing at that initial time. In a volatile market, that MVI will not reflect the fair value of services procured over different horizons or at different points in time, even if those procurements are all competitive and reasonable. **Consensus Agreed**
- Absent customer switching restrictions if the MVI price is set as a fixed cap, it effectively forces the LSE to grant a free “call option” to customers. “Prodigal customers” may choose to leave their ARES and return to POLR if/when market conditions change. **Consensus Agreed**
- Absent customer switching restrictions as a cap on power procurement costs, the call-option nature of MVI (or any other price cap) shifts all upside wholesale procurement price risk to LSEs. This is problematic and potentially very costly to the distribution company, given the observed volatility of wholesale electric markets. **Consensus Agreed**
- The market for relatively long-term products (e.g., forward contracts of 1 year or longer) may be far less liquid than the market for short-term (e.g., daily, monthly, or quarterly) products. The LSE, however, may reasonably be asked to purchase a mix of short-term and long-term products at different points in time to lessen price risk. To provide an “apples to apples” comparison, the MVI would need to reflect the mix of products purchased by the LSE and the expectations pertaining at the time

of purchase. With thin forward markets, which are common to electricity trading in many regions of the U.S., it may be inherently difficult to develop an MVI benchmark that is relevant to both short-term and long-term procurements. **Consensus Agreed**

- Does not encourage the development of wholesale competition. **Consensus Agreed**
- Absent significant changes in the underlying mechanics of the MVI process, directly tying the LDC's purchasing practices to the MVI may likely result in substantially all of the power and energy acquired by the major LDC's in the State, being priced simultaneously. Consumers could be at risk from the potential volatility in the wholesale market which may arise when such large volumes of power and energy are simultaneously bid in a relatively small geographical region, on an annual basis. **Consensus Agreed**

2. To the extent that a rate freeze remains in effect if there is no rate case, this scenario has all of the "Cons" associated with Scenario 7. **Consensus Agreed**

- Cost to extend contracts beyond 2006 may be higher than what is reflected in current rates. **Consensus Agreed**
- Possible lack of wholesale market development during extension due to uncertainty and prices that do not reflect market. **Consensus Agreed**
- Inconsistent with FERC affiliate transaction rules. **Consensus Agreed**
- Does not foster wholesale competition. **Consensus Agreed**
- Utilities do not have opportunity to recover cost increases on the T&D component of rates. **Consensus Agreed**
- Depending on underlying market condition, may lock in rates higher than what consumers might see absent a rate freeze. **Consensus Agreed**
- May result in an extension of the practice of procurement through affiliate, full-requirements contracts, with the associated lack of transparency. **Consensus Agreed**
- Does not make efforts to solve the issue of how to efficiently supply customers using standard-offer service. **Consensus Agreed**
- Continues regulatory uncertainty, which may stifle investment in generation and other resources. **Consensus Agreed**

- Depending on underlying market conditions, may lock in rates lower than what suppliers would see in the market, therefore eliminating any interest in serving the utility load by competitive suppliers. **Consensus Agreed**
- 3. May result in rates that do not reflect the market-based costs of the most efficient suppliers. **Consensus Agreed**

ICC Post-2006 Initiative Procurement Working Group
Scenario 9 Summary
Presented by MidAmerican Energy

Scenario 9 - Vertically Integrated Utility Supply

This scenario envisions that retail load not served by Retail Electric Suppliers will continue to be provided by an integrated utility which remains responsible for production, transmission, distribution, and customer functions, as prior to restructuring. Under this scenario, the ICC will continue to regulate rates for non-competitive service customers under traditional rate regulation principles. Utilities would be free to construct, purchase, operate and control resources required to supply this load and to collect costs thereof pursuant to traditional rate of return and regulation (or statutorily authorized regulation plans).

Scenario 9 is a procurement option for multi-jurisdictional utilities, such as MidAmerican Energy, whose primary jurisdiction (Iowa) has not been deregulated and who continue to own physical generation assets in the regulated entity. The scenario is a continuation of an existing utility structure and provides a way to preserve multi-jurisdictional operational efficiencies.

Use of existing and under-construction regulated generation for meeting standard offer load requirements would be allowed and a portion of the costs for this generation would be allocated to Illinois standard offer customers based on load share. Future resource needs would be acquired on a total system basis under a process similar to Scenario 6. Coordination of the procurement process with other jurisdictions would be necessary.

As presented to the ICC Procurement Working Group Scenario 9 is not re-regulation of the industry, would not be required for any utility (or even desirable for some utilities), would not require re-acquisition of generation formerly sold or spun off, and is not a pricing recommendation.

SCENARIO 9

PROS and CONS

PROS

1. May make procurement strategy easier for multi-jurisdictional utilities operating in a primary jurisdiction that has not been subject to vertical separation. **Consensus Agreed**
2. Multi-jurisdictional planning may lower the utility's costs versus regulating both jurisdictions separately. **Consensus Agreed**
3. May offer rate stability for customers **Consensus Agreed**
4. Provides for stakeholder review and input through rate filings and associated proceedings (but for Con #8). **Consensus Agreed**
5. Supply planning provides a forum and mechanism to identify the need for near- and long-term resources to assure adequate supply and reliability. **(Consensus Agreed)**

6. Can be structured to provide flexibility for each utility to tailor a procurement program that addresses its specific requirements. **(Consensus Agreed)**
7. Can be structured to provide a presumption in favor of competitive procurement for future resource needs. **(Consensus Agreed)**
8. Can be structured to incorporate flexibility to adjust procurement strategies on a going forward basis to respond to changes in market conditions and RTO market structure. **(Consensus Agreed)**
9. Does not prejudice, mandate, or preclude any specific procurement program for future resource needs. **(Consensus Agreed)**
10. As presented, this scenario provides review and approval of procurement strategies prior to a utility's commitment to specific resources. **(Consensus Agreed)**
11. Will help inform ICC for its participation in RTO and FERC proceedings through periodic wholesale market assessments. **(Consensus Agreed)**
12. Allows for DSM programs and renewable portfolio standards. **(Consensus Agreed)**
13. May facilitate direct participation by specialized or single asset owners for future resource needs. **(Consensus Agreed)**

CONS

1. Competitive suppliers could be precluded from competing for portions of the utilities' load requirements, even if they can supply at lower costs than the utility. **Consensus Agreed**
2. Impedes development of competitive wholesale electric markets and merchants investment in generation and other resources. **Consensus Agreed**
3. Limited regulatory oversight and opportunity for stakeholder comment because self-supply portfolio is reviewed and approved in a different jurisdiction. **Consensus Agreed**
4. May result in rates that do not reflect the market-based costs of the most efficient suppliers and therefore, may impede development of market based retail pricing and competitive retail supply. **Consensus Agreed**
5. As presented, this scenario provides utilities limited incentive to procure power efficiently. **Consensus Agreed**
6. May involve stranded cost risks due to customer switching. **Consensus Agreed**

7. Involves specific and detailed legislative changes necessary to support procurement for 2007 power supplies. **(Consensus Agreed)**
8. Involves a judgment-based review that does not lend itself to easily quantified metrics for decision-making. **(Consensus Agreed)**
9. It may not be possible to efficiently transition between procurement strategies as market conditions change. **(Consensus Agreed)**
10. To the extent that the utility would procure non-competitively, there is less transparency. **(Consensus Agreed)**
11. Could result in higher prices if the regulatory process requires the inclusion of above market resources in the portfolio. **(Consensus Agreed)**
12. Leaves several key and potentially contentious issues to be resolved in a later regulatory process, including procurement methodology, rate design, and allocation of risks. **(Consensus Agreed)**
13. To the extent procurement is through long-term supply contracts, this scenario may involve significant counterparty credit risk. **(Consensus Agreed)**

FACT

1. While it requires a demonstration of reasonable cost it does not require a demonstration that system-wide self-supply is a cost-effective means of serving customers in multiple jurisdictions. **Consensus Agreed**

Scenario 10 – Re-Regulation of Electricity Production

Scenario 10 should be regarded for the most part as a restoration of the *status quo ante* to the 1997 Choice Law. This scenario envisions an extension Scenario 9 to the point of reinstalling as the model for electric service the vertically integrated franchised monopoly involving the traditional rate-basing of generation assets and consequent cost of service

ratemaking for all elements of electric service. All retail load, other than that served by on-site or self-owned generation would be served by the local utility.

Procurement by utilities to meet their service obligations would involve a traditional combination of generation ownership and negotiated or other wholesale transactions. Owned generation would be certificated by the Illinois Commerce Commission for construction by the utility or acquisition of generation assets by the utility would be subject to Commission approval. All costs associated with owned generation would be subject to review for inclusion in retail rates. Wholesale transactions would be subject to review by FERC. The ICC could exercise its traditional scope of authority with respect to supply planning by the utility, including methods of wholesale acquisition.

Given existing conditions under which most generation in Illinois not currently owned or controlled by utilities, reacquisition of generation would be required if a substantial portion of production were to be re-regulated in the near future.

SCENARIO 10

Re-regulation of Electricity Production

PROS

1. Can yield stable rates. **(Consensus Agreed)**
2. Is compatible with various rate designs. **(Consensus Agreed)**
3. Provides for stakeholder review and input through rate filings and associated proceedings. **(Consensus Agreed)**
4. Provides for single point accountability. **(Consensus Agreed)**
5. Accommodates long-term bilateral contracts with independent suppliers. **(Consensus Agreed)**
6. Transparency of information regarding new generation. **(Consensus Agreed)**
7. Allows for DSM programs and renewable portfolio standards **(Consensus Agreed)**

CONS

1. Involves specific and detailed legislative changes necessary to support procurement for 2007 power suppliers. **(Consensus Agreed)**

2. Not a competitive procurement approach approved in the “Electric Service Customer Choice and Rate Relief Law of 1997”. **(Consensus Agreed)**
3. Unclear how utilities would re-acquire a generation portfolio. **(Consensus Agreed)**
4. Regulated return on re-acquired utility assets may not result in competitive market price for electricity. **(Consensus Agreed)**
5. No opportunity for customers to choose an alternate supplier and unclear as to the future of existing customer contracts. **(Consensus Agreed)**
6. Provides utilities limited incentive to procure power efficiently. **(Consensus Agreed)**
7. Does not foster development of competitive wholesale markets. **(Consensus Agreed)**
8. May not provide efficient price signals to consumers. **(Consensus Agreed)**
9. Poses significant regulatory risk related to after-the-fact prudence reviews. **Consensus Agreed**
10. May involve affiliate power contracts that are ~~be~~ difficult for regulators to evaluate and oversee. **Consensus Agreed**
11. Does not take advantage of competitive efficiencies. **Consensus Agreed**
12. Shifts all cost risks for new builds to customers **Consensus Agreed**
13. Significant costs and resources must be dedicated to potentially lengthy regulatory proceedings. **Consensus Agreed**
14. Decisions made through regulatory process may not include all information that would be provided by markets (expected costs, risk exposures and management opportunities, resource flexibility value, discount rate assumptions) **Consensus Agreed**
15. Involves risk that utilities will be unable to recover their costs. **Consensus Agreed**
16. Fuel price risks maybe passed through to customers through FAC. **Consensus Agreed**

Scenario 11

Supply Procurement

- Default provider arranges supply in a manner consistent with its credit policies and/or risk profile.
- Default provider's shareholders bear supply risk.

Large Customer Default Product Design

- Large customers have a great deal of market sophistication and have the ability to shop for products and services that meet their specific needs.
- The only default service for large customers is an hourly-priced product; this design will result in the largest number of retail suppliers offering competitive products to customers.
- There are no switching restrictions for large customers.
- Customers not selecting a provider are placed on hourly default service.
- Utilities providing default service not allowed to offer competitive products.
- The large customer default price includes a retail services fee to appropriately reflect retail market prices.

Small Customer Default Product Design

- Small commercial and residential customers face slower transition to robust competitive offers than the large customers due to lower consumption patterns, less financial incentive due to lower consumption, and the technological inability to respond to usage hourly.
- Therefore, compared to large customers, a less frequently adjustable default price is recommended.
- The Commission establishes an initial commodity price that allows for sufficient headroom when compared to market prices at the end of the transition period.
 - To allow for adjustment to wholesale price changes, a transparent adjustment mechanism is established based on a known market index.
 - In order to allow alternative retail providers to enter the market and remain in the market, the default provider has the opportunity to adjust the default price twice per year.
- Allowing retail prices to change with wholesale price changes ensures all parties that the default price will not become below market, thus allowing needed confidence for new market entrants and leading to robust, sustainable retail competition.
- Incumbent utility initially retains customers.

General Scenario 11 Attributes

- Accommodate RPS, EE initiatives, low-income assistance, etc.

SCENARIO 11

PROS AND CONS

PROS

1. Price to Beat (PTB) allows small customers a safety net. **Consensus Agreed**
2. New providers know what price they have to beat to gain customers. **Consensus Agreed**
3. Providers can adjust retail prices based on changes in wholesale prices. **Consensus Agreed**
4. Provides for customer choice. **Consensus Agreed**
5. Mitigates default providers' risk by allowing default prices to reflect changes in wholesale market prices up to twice a year for residential and small commercial customers. **Consensus Agreed**
6. Provides certainty to competitive providers that default prices will not become at or below market for any sustained period of time. **Consensus Agreed**
7. Transparent retail pricing and adjustment mechanism. **Consensus Agreed**
8. Stakeholders involved in determining details of default retail price and adjustment mechanism. **Consensus Agreed**
9. Allows for renewable portfolio standards, demand side management, low-income assistance programs, etc. **Consensus Agreed**
10. If successful in fostering retail competition, this scenario may produce a diverse offering of retail products. **Consensus Agreed**
11. May facilitate availability of retail products that appeal to select customer groups, such as "green power," where the provision of these products is tailored to market demand. **Consensus Agreed**

12. Appears to allow for flexibility in rate structure (seasonal, on-peak/off-peak, etc.).
Consensus Agreed

CONS

1. Could be structured to prevent an affiliate provider from competing against the price to beat until a certain percentage of customers switch to a different provider or a specific time frame expires. **Consensus Agreed**
2. Throughout the period of time the price to beat is designed to be above market to promote competition among suppliers. **Consensus Agreed**
3. Without switching restrictions this can result in supplier procurement risk.
Consensus Agreed
4. Relies on a workable competitive wholesale market. If the utilities in Illinois do not join PJM or MISO, the market design will be more difficult since workable wholesale markets form the basis of workable retail markets, allowing retail competitors to enter and sustain their operations. **Consensus Agreed**
5. Market design may produce faster switching for larger customers than for smaller customers. **Consensus Agreed**
6. Default product may not be the product of first choice. **Consensus Agreed**
7. Mass market customers who remain on default service (e.g., elderly, low-income) may face higher or more volatile retail prices. **Consensus Agreed**
8. Inertia, brand loyalty, or high switching costs typically can be expected to cause many residential customers and small businesses to remain with the default service provider under open retail competition **Consensus Agreed**
9. If wholesale market is not robustly competitive with many different suppliers competitive retail providers: may be hesitant to enter the market, forcing consumers to accept either default service or high-priced “competitive” retail service. **Consensus Agreed**
10. Does not require an open, transparent, competitive procurement process by the default service provider. **Consensus Agreed**
11. Does not by itself encourage the development of wholesale competition.
Consensus Agreed
12. Retail prices are subject to limited regulatory review and opportunity for public comment. **Consensus Agreed**

13. If not well designed, the administratively-determined rate adjustment mechanisms may fail to link retail rates to market prices, thereby resulting in rates that are well above-market or that are so low that competitive retail suppliers cannot compete.

Consensus Agreed

14. If not well designed, the rate adjustment mechanism may fail to provide retail rates that reflect market prices and the deviations may be magnified over time.

Consensus Agreed

FACTS

1. Procurement decisions not subject to regulatory scrutiny. **Consensus Agreed**

2. Incumbent utility is deemed the default provider instead of assigning customers straight to competitive retail suppliers. **Consensus Agreed**

3. Allows default provider to arrange supply in any manner it chooses. **Consensus Agreed**

4. The providers shareholders bear supply risk. **Consensus Agreed**

5. Customers are free to choose a provider at any time; there are no switching restrictions. **Consensus Agreed**

6. Customers may be able to choose different products from different providers. **Consensus Agreed**

7. Allows Commission review of small customer default price adjustments. **Consensus Agreed**

8. In Texas this market design allows for robust retail competition to exist. **Consensus Agreed**

- 99% of large customer load, 47% of small non-residential customer load, and 17% of residential customer load served by competitive providers:
- According to the Texas Public Utility Commission Scope of Competition Report, January 2003, residential price-to-beat savings were \$902 Million in 2002 compared to utility rates in place as of December 31, 2001.